

How we integrate ESG into our process

RBC European Equity team | April 2022



Short-termism and a view that ESG is a separate assessment criterion are both market weaknesses. We believe that ESG criteria should be considered in the same way as traditional financial criteria in terms of their capacity to affect shareholder value and therefore long-term investment performance.

Some ESG criteria are more relevant to certain industries and sectors, and so investors cannot use a one-size-fits-all approach to ESG analysis and integration. Screening and using filters, for example to exclude the highest emitters of greenhouse gases from a portfolio, can serve a useful tool for investment managers. Yet there is no substitute for managers making informed, explicit decisions without an over-reliance on external data.

We look at companies through three lenses: Operational Quality, Competitive Advantages, and Material Issue Management (ESG).

The last of these focuses on those ESG factors we see as most material and pertinent to the successful performance of that business. Rather than applying broad analytics, we prefer to look on a fundamental, bottom-up basis at those factors which, based on our proprietary material issue analysis and scoring, matter most to a business and its stakeholders. An example of how these factors may be analyzed on a company-by-company basis is shown in Figure 1.

The results of this analysis are then integrated into our financial analysis and, ultimately, into the decision to invest – or not – in a business. Including ESG factors in our fundamental analysis not only serves as an excellent risk management tool but, just as importantly, can provide us with opportunities at both a corporate and portfolio management level. We believe that this mindset, combined with our skillset as active managers, is how we can benefit our investors in the long run.

Figure 1: European Equity Team investment process: Material issue management (ESG)

Category	Luxury goods – Company A	Capital goods – Company B
Leadership and governance	<ul style="list-style-type: none"> Board composition Executive compensation Management quality Disclosure 	<ul style="list-style-type: none"> Board composition Executive compensation Management quality Disclosure
Social capital	<ul style="list-style-type: none"> Product quality and safety Data security 	<ul style="list-style-type: none"> Product quality and safety
Human capital	<ul style="list-style-type: none"> Labour practices 	<ul style="list-style-type: none"> Employee health and safety
Business model and innovation	<ul style="list-style-type: none"> Supply chain management Materials sourcing and efficiency 	<ul style="list-style-type: none"> Product design and lifecycle management Materials sourcing & efficiency
Environmental	<ul style="list-style-type: none"> Water and wastewater management Energy management 	<ul style="list-style-type: none"> Energy management GHG emissions

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